INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	6
Reasons for granting the writ	7
Appendix	13

CITATIONS

Cases:	
G & K Mfg. Co. v. *Commissioner*, 76 F. (2d) 454	7
Gregory v. *Helvering*, 293 U. S. 465	11
Mead Coal Co., C. H. v. *Commissioner*, 72 F. (2d) 22	7
Nelson Co., John A. v. *Commissioner*, 75 F. (2d) 696, now pending before this Court, No. 61, October Term, 1935	7
Pinellas Ice Co. v. *Commissioner*, 287 U. S. 462	8
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227. Sec. 202	8
Revenue Act of 1924, c. 234, 43 Stat. 253. Sec. 203 (U. S. C., Title 26, Sec. 934)	8
Revenue Act of 1926, c. 27, 44 Stat. 9. Sec. 203 (U. S. C. App., Title 26, Sec. 934)	8
Revenue Act of 1928, c. 852, 45 Stat. 791. Sec. 112	13–14
Miscellaneous:	
H. Rep. No. 179, 68th Cong., 1st Sess., p. 16	9
S. Rep. No. 398, 68th Cong., 1st Sess., p. 17	9
Treasury Regulations 74, Article 577	15–16

143938—35——1

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

MINNESOTA TEA COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit entered in the above-entitled cause on March 25, 1935.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 99–109) is reported in 28 B. T. A. 591. The opinion of the Circuit Court of Appeals is reported in 76 F. (2d) 797.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 25, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the definition of the term "reorganization" contained in clause (A) of Section 112 (i) (1) of the Revenue Act of 1928 should be limited to transactions which partake of the nature of mergers or consolidations.

2. Whether the statute may be availed of where it appears that preparatory to the transfer in question the taxpayer divested itself of certain assets and that only as thus reduced was there a transfer of "substantially all" of its property.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix, *infra*, pp. 13–16.

STATEMENT

The facts, as stipulated before the Board of Tax Appeals (R. 13–16), are substantially as follows:

The respondent is a Minnesota corporation, with principal office at 2023 West Superior Street, Duluth, Minnesota, and was, until the transfer of its assets hereinafter mentioned, engaged in the business of selling teas, coffees, and groceries at retail. (R. 14.)

On July 14, 1928, the respondent formed, or caused to be formed, the Peterson Investment Company, a corporation, and transferred thereto certain of its assets in exchange for the entire capital stock of Peterson Investment Company. The assets so transferred to the newly formed corporation consisted of real estate and buildings, investments, and other miscellaneous assets. Immediately upon receipt of the stock of Peterson Investment Company it was distributed by respondent *pro rata* among its stockholders. On August 23, 1928, respondent transferred all of its remaining assets to Grand Union Company, another corporation, and received in exchange therefor 18,000 shares of common stock of said Grand Union Company, plus $426,842.52 in cash. (R. 14.)

The transfer effected was accomplished in accordance with the following plan (R. 14; R. 19–25, Ex. B):

On July 2, 1928, the respondent's officers granted an irrevocable option to O. B. Westphal (who was acting as agent for Grand Union Company), to acquire the respondent's inventories, bills, notes, and accounts receivable, furnishings and equipment, and good will in exchange for Voting Trust Certificates for 18,000 shares of common stock of the Grand Union Company, plus $400,000 in cash, plus or minus the difference between the value of the assets at the date of conveyance and the value

on December 31, 1927. Under this option, if exercised, the respondent obligated itself to sell, and the Grand Union Company to buy, the above-described assets. (R. 14.)

On July 6, 1928, the option of July 2, 1928, was accepted. (R. 14.)

On July 24, 1928, an agreement, supplemental to the option of July 2, 1928, was accomplished, fixing August 25, 1928, as the delivery date and providing, for convenience, that the valuation date of the assets should be August 4, 1928, instead of the delivery date. (R. 14; R. 29, Ex. D.)

On August 22, 1928, the stockholders of the respondent adopted a resolution (1) ratifying the action of the respondent's officers in signing the option of July 2, 1928, and the agreement of July 24, 1928; (2) authorizing the sale and transfer of all its assets upon the terms stipulated in the option and modifying agreement, or upon such other terms as the directors might deem advisable; and (3) providing that the corporate stock to be received in exchange should be retained by the respondent and that the cash to be received in exchange should be immediately distributed to the respondent's stockholders in proportion to their respective stockholdings. (R. 14; R. 16–19, Ex. A.)

On August 23, 1928, the stockholders of the respondent adopted a resolution authorizing the officers to execute and deliver a bill of sale and instrument transferring the property to the Grand Union Company. (R. 15; R. 32, Ex. E.)

Upon receipt of the cash and stock, the respondent immediately paid the entire sum of $426,842.52 to its stockholders in proportion to their stockholdings, and the stockholders agreed to pay the corporate debts. (R. 15.)

Under the option, resolution, bill of sale, and all the agreements whereby the transfer of respondent's assets to the Grand Union Company for cash and stock of the latter was accomplished, the transaction is described as one of purchase and sale; the respondent being described as the "seller", and the Grand Union Company, or its agent, "the buyer". (R. 16, 20, 26, 30, 36.)

The amount of the liabilities of the respondent at August 23, 1928, which were assumed and discharged by the stockholders of respondent, pursuant to corporate resolution, was $106,471.73. (R. 15.)

Petitioner, in determining the proposed deficiency herein, added to respondent's taxable income an amount of $106,471.73, representing an alleged profit realized upon the above transfer of assets to the Grand Union Company. (R. 15.) If the said amount of $106,471.73 so added by the petitioner to respondent's taxable income be excluded therefrom, respondent sustained a net loss for the year 1928, in the event the transaction involved constituted a statutory reorganization. (R. 16.)

The matter was thereupon brought before the Board of Tax Appeals for review, upon the issue

of whether or not the respondent realized a taxable gain of $106,471.73, as a result of the transactions above set forth. (R. 4–5.) The petitioner and respondent proceeded on the assumption that a statutory reorganization had been effected. (R. 116.) The Board of Tax Appeals, of its own motion, raised the question as to whether such statutory reorganization had been effected,[1] and in its decision held that there was no reorganization, and that the respondent realized a gain measured by the difference between $254,646.62, the cost of its property, and $966,842.52 (being the sum of $426,842.52 cash and $540,000, the value of 18,000 shares of Grand Union Company), and held that this gain of $712,195.90 was taxable. (R. 100–106.) The Circuit Court of Appeals reversed the Board, holding that the transaction was a reorganization.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

In failing to limit the definition of "reorganization" contained in clause (A) of Section 112 (i) (1) of the Revenue Act of 1928 to transactions which partake of the nature of a merger or consolidation.

[1] In this connection, the Board of Tax Appeals gave both counsel opportunity to brief fully the question of whether or not there had been a statutory reorganization. Counsel for the respondent accordingly submitted a brief thereon prior to the promulgation of the Board's opinion. (R. 116, 125.) This statement is due the Board of Tax Appeals in order that it may appear that its decision was not reached without affording the parties a full opportunity to be heard.

2. In giving effect to an administrative construction which is inconsistent with the statute.

3. In failing to hold that the transaction here involved was not a reorganization within the meaning of the Revenue Acts.

4. In failing to take into account the fact that the respondent had made an anticipatory transfer of the portion of its assets not desired by the Grand Union Company, and hence that the transfer to the Grand Union Company was not a substantial compliance with the statutory requirement that "substantially all" of the property be transferred.

5. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in conflict with *C. H. Mead Coal Co.* v. *Commissioner,* 72 F. (2d) 22 (C. C. A. 4th); *John A. Nelson Co.* v. *Commissioner,* 75 F. (2d) 696 (C. C. A. 7th), now pending before this Court on petition for certiorari, No. 61, October Term, 1935, and *G & K Mfg. Co.* v. *Commissioner,* 76 F. (2d) 454 (C. C. A. 4th). These decisions hold that the parenthetical language found in clause (A) of Section 112 (i) (1) of the Revenue Act of 1928 (*infra,* p. 14), namely;

> The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation) * * *

should be limited to transactions which partake of the nature of mergers or consolidations. This construction is consistent with the decision of this Court in *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462, where it was said (pp. 469–470):

> The words within the parenthesis may not be disregarded. They expand the meaning of "merger" or "consolidation" so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness cannot be designated as either merger or consolidation. * * *

However, the court below in the present case gave no consideration to whether the transaction partook of the nature of a merger or consolidation, holding that the transaction satisfied the literal language of the statute, that the stock represented a continuity of interest, and that the statute required nothing more.

The definition in clause (A) had its origin in Section 202 (c) (2) of the Revenue Act of 1921 (c. 136, 42 Stat. 227) and was reenacted in the Revenue Acts of 1924 (c. 234, 43 Stat. 253), 1926 (c. 27, 44 Stat. 9), and 1928[2] (*infra*, p. 14). However, the Revenue Act of 1924 contained an additional defi-

[2] Section 203 (h) (1), Revenue Acts of 1924 (U. S. C., Title 26, Sec. 934) and 1926 (U. S. C. App., Title 26, Sec. 934); Section 112 (i) (1), Revenue Act of 1928 (*infra*).

nition, which now appears as clause (B) of Section 112 (i) (1) of the Revenue Act of 1928 (*infra*), namely:

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred * * *

"Control" is defined in Section 112 (j) as the ownership of at least 80 per centum of the total number of shares, including at least 80 per centum of the voting stock. Since clause (A) already defined as a reorganization the acquisition of substantially all the properties of another corporation, and did not require that the transferor should have control of the transferee, the additional definition in clause (B) clearly overlaps clause (A) if the clause (A) definition is literally applied. The legislative history of clause (B)[1] shows that it was intended to include transactions not already provided for by clause (A), and it is therefore apparent that the two definitions were intended to be mutually exclusive and that they should be applied to achieve that result.

It is true that the administrative officers have recognized a transaction such as is here involved as satisfying the statute. This administrative prac-

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[1] H. Rep. No. 179, 68th Cong., 1st Sess., p. 16; S. Rep. No. 398, 68th Cong., 1st Sess., p. 17.

tice, adopted when there was but one applicable definition, was continued after Congress had clearly required that in the case of some reorganizations accomplished by the transfer of corporate assets the transferor must acquire a stock control of the transferee. We submit that this was a mistaken construction which gave no heed to the necessity of correlating the clause (A) definition with the clause (B) definition.

By limiting the clause (A) definition to transactions which partake of the nature of mergers or consolidations, there will be room for the exclusive application of both clause (A) and clause (B); the clause (B) definition will cover transactions not already provided for when it was first introduced into the statute; the Congressional purpose to enlarge the scope of the original definition will be satisfied and the anomalous situation will be avoided of having two applicable definitions with different requirements.

We do not contend, as suggested by the court below, that the requirement of control, found in clause (B), is to be incorporated in clause (A). That would only accomplish a further overlapping. Our position is that transactions which partake of the nature of mergers or consolidations may be treated as reorganizations (assuming that they comply with other requirements) without regard to the stock-control requirement of clause (B).

2. The dissenting opinion below not only approved the reasoning of the Board of Tax Appeals

but advanced as a separate ground for sustaining its decision that the transfer by the respondent to the Grand Union Company did not consist of substantially all of respondent's property. It clearly appears that preparatory to this transfer respondent had divested itself of other property by a transfer to a newly organized corporation, in exchange for the entire capital stock of the latter, which respondent immediately distributed to its own stockholders. The Board found (R. 101) that "Thus reduced, the entire assets * * * were transferred to the Grand Union Co." The transfer to the newly organized corporation (R. 14) embraced the assets not desired by the Grand Union Company (R. 20) and which would otherwise have been retained by the respondent. It does not appear that without the prior transfer respondent would have had a basis for the contention that substantially all of its assets were transferred to the Grand Union Company. The statute may not be availed of to exempt the gain from an "elaborate and devious form of conveyance masquerading as a corporate reorganization" (*Gregory* v. *Helvering*, 293 U. S. 465, 470), and in this view the decision below may be fairly said also to be in conflict with the cited case.

3. The reorganization statutes have given rise to much litigation. This case involves the statutory definition and deals with a basic question which is necessarily presented in all reorganization cases. Its decision will have a wide applica-

tion, not only in cases involving the transfer itself, but also in cases dealing with the question of the proper basis for depreciation and depletion of the property transferred and the basis for gain or loss when the property is disposed of by the transferee. The confusion resulting from the inconsistent administrative practice and the conflicting decisions justifies the intervention of this Court.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

JUNE, 1935.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distrib-

ute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place or organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Treasury Regulations 74 (promulgated under the Revenue Act of 1928):

ART. 577. *Definitions.*—The term "reorganization," as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 percent of the voting stock, and

(2) At least 80 percent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

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